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Committee on Government Reform and Oversight
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DISTRICT OF COLUMBIA

Status of Sports Arena and
Convention Center Projects

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Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss the results of our work that you requested on the proposed new sports arena and convention center projects in the District of Columbia. For the sports arena project, we will discuss the District's predevelopment costs for the project, how those costs will be financed, and what revenues will be generated from a new dedicated tax to finance the costs. For the convention center project, we will discuss what revenues have been generated from new dedicated taxes, where they have been deposited, and how the District plans to use these revenues.

RESULTS IN BRIEF

The District's estimated predevelopment costs for the sports arena project total \$56 million. To finance these costs, the District planned to borrow, through the Redevelopment Land Agency (RLA), up to \$53 million from a syndication of banks headed by NationsBank and Crestar Bank and use an estimated \$9 million in annual revenues from the Arena Tax to repay the loan over 7 to 10 years. However, during the past week, the RLA has received other financing proposals, which involve issuing a combination of tax-exempt and taxable bonds at various interest rates over a period of up to 20 years. Because these new financing proposals are so recent, we did not have an opportunity to gain a full understanding of their terms and conditions.

Our analysis indicates that (1) the District has included all predevelopment costs associated with the project that are known and can be estimated at this time and (2) the Arena Tax should provide sufficient revenue to repay the maximum amount of the loan if the District's key tax projection assumptions are achieved. In addition, if the District is successful in obtaining a federal grant to assist in constructing the Metrorail connection to the arena, the amount it would need to borrow would be reduced by about \$10.8 million.

For the convention center, the District received and deposited \$16.2 million in new taxes dedicated to the Washington Convention Center Authority¹ (Authority) as of July 11, 1995, covering the 7-month period October 1, 1994, to April 30, 1995. The tax collections to date, which have been deposited in an interest-bearing escrow account, are approximately 53 percent of the \$30.8 million projected for fiscal year 1995. Until the Congress amends the District of Columbia's Self-Government and Governmental Reorganization Act (Home Rule Act)² to permit the Authority to use the dedicated tax revenues, the Authority cannot (1) contract for the various studies necessary to better define the project proposal for the new convention center and (2) expend funds for the operation and maintenance of the existing convention center during fiscal year 1995 and

¹The Authority was created by the Washington Convention Center Authority Act of 1994, DC Act 10-314, signed by the Mayor on August 2, 1994 (Act 10-314: 41 DCR 5333).

²Public Law 93-198, 87 Stat. 744 (1973).

future fiscal years until such time that the new convention center is constructed and operating.

SCOPE AND METHODOLOGY

In our assessment of the sports arena and convention center projects, we (1) obtained an understanding of the methodology used for the revenue projections of the dedicated taxes associated with these two projects, (2) obtained the bank statements for the escrow and lock box accounts to support the taxes collected and deposited as of July 10, 1995, for the sports arena project and July 11, 1995, for the convention center project, respectively, and (3) obtained the documentation supporting the predevelopment costs and the bank financing for the sports arena project available at the time we performed our work.

We met with and obtained information from District officials on the Gallery Place Arena Task Force and other District officials in several of District agencies, including the Office of Finance and Revenue, the Office of the Corporation Counsel, the Office of the Executive Secretary, the Redevelopment Land Agency, the D.C Sports Commission, and the Washington Convention Center Authority. We also met with and obtained information from the staff of the Council of the District of Columbia and officials of NationsBank, Crestar Bank, the Washington Metropolitan Area Transit Authority, the D.C. Arena Associates, the National Capital Development Corporation, the Washington Convention and Visitors Association, and the Hotel Association of Washington, D.C.

We did not audit or review the reported taxes collected and deposited for the sports arena and convention center projects to determine if the District Government accurately calculated and transferred all taxes dedicated to these projects to their respective escrow accounts. Also, we did not audit the historical data or evaluate the assumptions underlying the tax revenue projections. Furthermore, we did not audit the sports arena predevelopment cost estimates to determine their reasonableness, and we did not evaluate the various sports arena financing proposals to ascertain which proposals result in the least cost to the District. Accordingly, we do not express an opinion or any other form of assurance on the taxes collected, the District Government's revenue projections or assumptions, the sports arena's predevelopment cost estimates, or the various financing proposals for the sports arena. The information presented in this testimony was prepared for the Subcommittee as it considers H.R. 1843, the District of Columbia Sports Arena Financing Act of 1995 and H.R. 1862, the District of Columbia Convention Center Preconstruction Act of 1995. Events and circumstances may occur after the date of this testimony that may change the sports arena and convention center dedicated tax projections and cost estimates. Our assessment was built on previous work,³ and we

³District of Columbia: Status of Convention Center Project (GAO/AIMD-94-191, Sept. 15, 1994 and District of Columbia: Status of Sports Arena Project (GAO/AIMD-94-192, Sept. 15, 1994).

conducted new work from May through July 1995 in accordance with generally accepted government auditing standards.

SPORTS ARENA PROJECT

Because of the District's financial crisis, the owner of the Washington Bullets and Washington Capitals (franchises) announced on December 28, 1994, that he would build a 20,600 seat, state-of-the-art arena, which the District was originally planning to build, if the District would pay for the predevelopment costs of the project. On March 6, 1995, the owner of the franchises and the Mayor of the District of Columbia signed an exclusive development rights agreement, whereby D.C. Arena L.P.--a limited partnership established by the owner of the franchises--will build an arena for an estimated \$175 million, and the District will purchase the land and make other infrastructure improvements which are estimated to cost \$56 million. The arena is to be built in the downtown area of the city commonly referred to as Gallery Place.

Under the agreement, D.C Arena L.P. will incur all costs associated with the design, development, construction, financing, and operation of the arena; arrange and repay all financing needed for the development, construction, and equipping of the arena and be responsible for all cost overruns and completion delays; sign a 30-year ground lease with the District with the option to extend the lease for two 10-year periods and pay \$300,000 per year to the District with increases of \$200,000 in years 7, 11, 16, 21, 26, and each 5-year interval period of any extension period; and have the Washington Bullets and Washington Capitals play all their home games in the arena for at least 30 years. Regarding arena operations, D.C. Arena L.P. will have the right to all revenues generated from rent, title sponsorship, founders suites, suites, club seats, ticket sales, concessions, novelties, advertising, and parking. Also, D.C Arena L.P. will be responsible for all expenses associated with the project, including repairs and maintenance and all capital infrastructure costs. All tickets and merchandise sales will be subject to District sales tax, but the arena will be exempt from District real estate taxes during the term of the ground lease.

Predevelopment Costs of Project

Under the agreement, the District will incur all costs associated with (1) acquiring land, including the purchase of non-District owned property, (2) connecting the Gallery Place Metrorail Station to the arena, (3) relocating District employees now in a District-owned building and in a leased building located at the Gallery Place site, and (4) demolishing buildings, relocating utilities, and securing all regulatory approvals necessary for construction. As table 1 illustrates, the District's original estimate of \$53 million for this project has been further refined, and it is now \$56.3 million. The estimated cost of land acquisition and the Metrorail connection increased about \$2.1 million and \$6.5 million, respectively, while the estimated costs of (1) relocating District employees and

Table 1: The District's Predevelopment Costs for the Sports Arena

Predevelopment costs	Original budget	Revised budget
Land acquisition		
Appraisal/purchase price		\$30,107,913
Appraisal fees		33,500
	\$28,000,000	30,141,413
Metrorail connection		
Construction costs for station entrance/exit and mezzanine	7,000,000	13,499,788
Relocation of District employees		
Lease commitments and rent advances		1,985,907
Lease appraisals and space consultants		70,000
Leasehold improvements		972,370
Furniture and equipment move		638,123
Telecommunications equipment move		875,133
	7,000,000	4,541,533
Building demolition, utility relocation, legal and environmental consultants, and bank fees		
Building demolition		1,393,401
Utility relocations		3,439,740
Business relocation		25,000
Legal, environmental and other consultants		1,816,302
National Capital Development Corporation reimbursement		294,318
Bank fees and costs		1,161,250
	11,000,000	8,130,011
Total predevelopment costs	\$53,000,000	\$56,312,745

Source: District of Columbia Gallery Place Arena Task Force financial information on the sports arena project.

(2) demolishing buildings, relocating utilities, and securing all regulatory approvals decreased by about \$2.5 million and \$2.9 million, respectively. Our analysis of the revised estimate of the predevelopment costs indicates that the District has included all predevelopment costs associated with the project that are known and can be estimated at this time. Let me address the costs in each of the four major categories.

Land acquisition (\$30.1 million) - The District's Redevelopment Land Agency currently owns the land between 6th, 7th, F, and G Streets which represents most of the land the arena will occupy. In addition, the arena will occupy up to 125 feet of property north of the G Street curb located between 6th and 7th Streets. The District currently owns the land and building at 613 G Street, but it will need to purchase two parcels of land, one of which includes a building. The parcel with the building, which the District is presently leasing is at 605 G Street, and it is owned by the Unification Church. The second parcel is between 7th Street and the 613 G Street property line, and it is owned by Washington Metropolitan Area Transit Authority (WMATA) and Mel Simon, a private developer.

On April 13 and 17, 1995, the two properties were appraised at \$30,107,913 by a D.C. Certified General Real Property Appraiser, who has extensive real estate appraisal experience in the District. The District does not plan to purchase these properties until (1) the Congress has approved the necessary Home Rule amendments for this project, (2) the District has received approval of its financing, and (3) the D.C. Arena L.P. has submitted a financing plan. If the project goes forward, RLA will tender offers to the owners of the land required for the arena. If the owners do not accept RLA's offer, then RLA plans to take the property through condemnation and the owners can contest the offer through the courts. The title to the land under the building at 613 G Street, which the District already owns, has already been transferred to RLA.

Metrorail connection (\$13.5 million) - An integral part of this project is the connection of the Gallery Place Metrorail Station to the arena--estimated to cost \$13,499,788. According to WMATA officials, the estimate is based on the best available data. When the final design plans are completed, they will be able to develop a final cost. The District plans to finance the construction of the Metrorail connection with funds from its bank loan. However, the District has also applied for a \$15 million Capital Assistance Grant under the provisions of the Intermodal Surface Transportation Efficiency Act of 1991⁴ to finance the construction costs of the Metrorail connection. The grant requires a 20 percent local contribution by the District--in this case, \$3 million. If the grant is approved, the District would receive \$12 million from the federal government. The project

⁴Public Law 102-240, 105 Stat. 2090 (Dec. 18, 1991) authorizes the Secretary of Transportation to make grants or loans to assist states and local public bodies and agencies to finance the acquisition, construction, reconstruction, and improvement of facilities and equipment for use, by operation or lease, in mass transportation service in urban areas.

grant was approved by the WMATA Board of Directors on June 8, 1995. It must also be approved by (1) the Transportation Planning Board of the Metropolitan Washington Council of Governments, which could occur on July 19, 1995, when the Board is scheduled to meet, and (2) the U.S. Department of Transportation, which according to Transportation Department officials could take about 3 months after the Transportation Planning Board's approval. If the grant is approved, the District would lower its financing requirements for the sports arena project by about \$10.8 million, which is the difference between the current estimated construction costs of \$13.5 million for the Metrorail connection and the District's related \$2.7 million (20 percent of \$13.5 million) contribution under the grant. The District could use the balance of the grant funds and the District's contribution (\$1.2 million federal grant and \$0.3 District contribution) for other transit-related projects.

Relocation of District employees (\$4.5 million) - To assemble the necessary land for the sports arena, the buildings at 605 and 613 G Street must be vacated and demolished. As of June 27, 1995, there were 792 District employees located in these buildings. According to District officials, they plan to move 720 employees into leased space and 72 employees into District-owned space. The District plans to lease 166,586 square feet of space at 941 North Capitol Street, N.E. A final contract is still being negotiated, but District officials told us that they expect to lease the space at \$21 per square foot. The lease payments for the offices relocated from 605 G Street, which the District was leasing, will be paid with funds from the affected District agency budgets. For those offices relocated from 613 G Street, which the District owned, lease payments will be paid from the sports arena financing for the first year only; thereafter, the affected District agencies are to make the lease payments. On the basis of \$21 per square foot, the District has estimated this cost at \$1,985,097 annually. Also, the District estimates that it will cost \$70,000 for lease appraisals and space consultants and \$972,370 for leasehold improvements. The District's estimated cost to move furniture and equipment is \$638,123, and the telecommunications relocations are estimated at \$875,133.

Building demolition, utility relocation, legal and environmental consultants, and bank fees (\$8.1 million) - The District estimates that it will cost \$1,393,401 to demolish the buildings at 605 and 613 G Street. This estimate includes \$505,000 for soil remediation at the site. Relocating utilities, street lights, and traffic signals is projected to cost \$3,439,240. The relocation of telephone facilities is the most expensive component--estimated at \$2,934,240--because the cable duct currently runs down the middle of G Street, and there is not enough room for the duct, the floor of the arena (25 feet below street level), and the Metrorail Red Line (27 feet below street level) to fit in the same location.

The District estimates that legal, environmental, and other consultants associated with the predevelopment phase of the project will cost \$1,816,302. The majority of these costs--an estimated \$1,450,000--are for the preparation of the environmental impact study. The National Capital Development Corporation, which was originally going to own and operate the sports arena, will be reimbursed \$294,318 for predevelopment costs it incurred on the

project before D.C. Arena L.P. decided to build the arena. Fees and costs associated with the project's financing, if the loan with NationsBank and Crestar Bank is accepted, are estimated at \$1,161,250, with \$861,250 being for the 1.625 percent loan commitment fee (based on a loan amount of \$53 million) and the remaining \$300,000 being for legal costs and due diligence fees.

Financing of Project's Predevelopment Costs

To finance the predevelopment costs for the arena project, the District is currently negotiating a loan with NationsBank and Crestar Bank. The most recent and significant terms and conditions of this proposed loan are as follows:

- **Lenders** - NationsBank and Crestar Bank will provide up to \$20,000,000 and syndicate the remaining \$33,000,000 with other banks.
- **Borrower** - Redevelopment Land Agency.
- **Amount** - Up to \$53 million term loan with a draw period.
- **Interest rate** - 30-day London Interbank Offered Rate (LIBOR),⁵ plus 200 basis points. As of July 11, 1995, the 30-day LIBOR was 5.90625, plus 200 basis points (2 percent). This equates to 7.90625 percent.
- **Interest rate protection** - The variable interest rate must be protected by using a swap,⁶ cap,⁷ or some other instrument acceptable to the banks.
- **Repayment term** - Amortized over a period of 7-10 years.
- **Sources of repayment** - These include all proceeds from the Arena Tax, income from the ground lease with D.C. Arena L.P., and additional sources of repayment identified and approved by appropriate legislative, regulatory, and other authorities. The proceeds of the Arena Tax will be remitted directly to a lockbox and deposited to a cash collateral account maintained by a designated agent. (A lockbox has been established at Signet Bank.)
- **Security** - This includes a perfected pledge and first lien on all proceeds of the Arena Tax, an assignment of the ground lease between RLA and D.C. Arena L.P., and a

⁵LIBOR is a variable interest rate at which deposits of U.S. dollars are traded in London. It is the Eurodollar equivalent for the federal funds rate. LIBOR is usually the rate used for other large Eurodollar loans to less creditworthy corporations and government borrowers.

⁶A swap is used to protect a floating liability from adverse movements in interest rates by converting it into a fixed rate. In a swap, two parties agree to exchange periodic interest payment obligations on an agreed principal amount for a specified time period.

⁷A cap is used to provide protection against rising interest rates. A cap enables a borrower to set an upper limit on its floating interest rate expense.

perfected pledge on identified additional sources of repayment identified and approved by appropriate legislative, regulatory, and other authorities.

- **Loan commitment fee** - An amount equal to 1.625 percent of the loan commitment.
- **Closing costs** - Borrower pays all closing costs.
- **Legal costs** - Capped at \$150,000.
- **Due diligence costs** - Non-refundable fee of \$150,000, plus all legal fees incurred by lenders to complete due diligence process.

After reviewing the terms and conditions of this proposed loan, the RLA sought and received other financing proposals during the past week to determine if it could secure financing more favorable to the District. RLA received a proposed term sheet from Morgan Stanley & Co. on July 6, 1995, and a preliminary term sheet from William Blair & Company on July 7, 1995, both of which would issue a combination of tax-exempt and taxable bonds at various interest rates over a period of up to 20 years. Because these new proposals are so recent, we did not have an opportunity to gain a full understanding of their terms and conditions.

For each financing proposal, it is important to understand, however, how total interest costs are affected by the amount borrowed, the interest rates, and the length of amortization periods. In table 2, we show the annual debt service costs if the District borrowed the \$53 million needed for the predevelopment costs of the arena project assuming all principal was drawn down immediately, the interest rate was fixed, and the loan was amortized evenly over the life of the loan from the time of drawdown. While these assumptions are not intended to replicate the conditions of any of the current proposals, these tables do show how annual debt service costs can decrease as the principal of the loan is amortized over longer periods of time. However, extending the amortization period would increase total interest costs.

Table 2: Annual Debt Service Costs for a \$53 Million Loan
Dollars in millions

Years to amortize	Fixed interest rate				
	7%	7.5%	8%	8.5%	9%
7	\$9.6	\$9.8	\$9.9	\$10.1	\$10.2
8	8.7	8.8	9.0	9.2	9.3
9	8.0	8.1	8.3	8.4	8.6
10	7.4	7.5	7.7	7.9	8.1
20	4.9	5.1	5.3	5.5	5.7

If the District is approved for the \$15 million Capital Assistance Grant for the construction of the Metrorail connection to the arena, the amount it would need to borrow would be reduced by about \$10.8 million. Table 3 illustrates what the annual debt service and total interest costs would be if the District borrowed \$42 million using the previously discussed assumptions.

Table 3: Annual Debt Service Costs for a \$42 Million Loan
Dollars in millions

Years to amortize	Fixed interest rate				
	7%	7.5%	8%	8.5%	9%
7	\$7.6	\$7.7	\$7.9	\$8.0	\$8.1
8	6.9	7.0	7.1	7.3	7.4
9	6.3	6.4	6.6	6.7	6.8
10	5.9	6.0	6.1	6.2	6.4
20	3.9	4.1	4.2	4.4	4.5

The total interest costs incurred can be reduced if the loan is repaid early. Over the term of the debt, however, interest costs are only one of the costs of obtaining financing. Various other costs such as commitment fees, due diligence costs, and insurance costs would have to be included in order to compare various proposals.

To pay for the loan and other predevelopment costs for the arena project, the District enacted the Arena Tax,⁸ which became effective October 1, 1994. The tax uses the same rate schedule as the one-time Public Safety Fee⁹ that was collected in fiscal year 1994. The District collected approximately \$9.5 million in Public Safety Fee taxes from feepayers who are also subject to the Arena Tax. (See table 4.)

⁸Arena Tax Amendment Act of 1994, D.C. Law 10-189, September 28, 1994. The Arena Tax is a gross receipts tax on all for profit organizations.

⁹The Public Safety Fee was a gross receipts tax on all for profit and nonprofit organizations.

Table 4: Collections from 1994 Public Safety Fee

Gross receipt range (dollars)	0 200,000	200,001 500,000	500,001 1,000,000	1,000,001 3,000,000	3,000,001 10,000,000	10,000,001 15,000,000	15,000,001 & greater	Total collected
Fee amount	\$25.00	\$50.00	\$100.00	\$825.00	\$2,500.00	\$5,000.00	\$8,400.00	
Amount paid	493,850	239,167	270,498	2,021,592	3,021,378	938,329	2,492,583	9,477,397
Returns filed	19,779	4,377	2,674	2,483	1,234	188	321	31,056

Note: The amounts represent the non-exempt filers as of June 26, 1995.

On the basis of the Public Safety Fee's 1-year collection history, the current Arena Tax fee structure, and assuming that the number of tax returns filed remains relatively unchanged, the District estimates that the Arena Tax collections should be no less than \$9 million each year. As of July 10, 1995, the District reported that it had collected approximately \$7.2 million from the Arena Tax which included about 21,000 returns filed, and additional returns are still being processed. Using the above assumptions, if the District borrowed (1) \$53 million at fixed interest rates up to 8 percent for 8, 9, 10, or 20 years or up to 9 percent for 9, 10, or 20 years or (2) \$42 million at fixed interest rates up to 9 percent for 7, 8, 9, 10, or 20 years, the Arena Tax collections should be sufficient to cover the loan's annual debt service.

Legislative and Regulatory Approvals

Before construction can begin on the sports arena, a number of legislative and regulatory approvals must be obtained. Foremost is amending the Arena Tax Amendment Act of 1994 to (1) permit the use of the tax revenues to finance the acquisition of land, the demolition of buildings, the relocation of District employees, and the reimbursement of District agencies for any predevelopment and development costs associated with the arena project, (2) authorize RLA, or some other District agency, to borrow funds for the arena project and pledge the revenues from the Arena Tax as security for the borrowing of funds, and (3) require the Mayor of the District of Columbia to adjust the rates of the Arena Tax if the annual revenues estimated are less than \$9 million. Legislation has been submitted to the D.C. City Council, and the Home Rule Act requires two readings of a bill before it can be passed. The D.C. City Council had its first reading of the bill on July 11, 1995, and the second reading is scheduled for July 25, 1995. If the bill is passed by the D.C. City Council and signed by the Mayor, the next step would be for the Congress to amend the Home Rule Act to permit RLA, or some designated authority, to borrow funds for the development and construction of a sports arena and to pledge District revenues as security for the borrowing of funds. On June 7, 1995, Delegate Norton introduced H.R. 1843 to grant the necessary authorizations.

In addition, a number of regulatory approvals are necessary. The major ones include approval of (1) the urban renewal plan amendments by the National Capital Planning

Commission (NCPC), the D.C. City Council, and RLA, (2) the environmental impact and historical preservation studies by NCPC, (3) the G Street and Alley closing by NCPC and the D.C. City Council, and (4) the ground lease agreement with D.C Arena L.P. by RLA. All of these regulatory approvals are in various stages, and they are scheduled to be completed by October 12, 1995. In addition, the District must acquire the necessary land, move its employees, and demolish two buildings by October 12th, so that the D.C. Arena L.P. can break ground for the arena on October 13, 1995.

CONVENTION CENTER PROJECT

In August 1994, when the District enacted legislation creating the Washington Convention Center Authority, it also established new taxes to provide a source of revenue for the Authority. These dedicated taxes, which became effective October 1, 1994, were as follows:

- 2.5 percentage points of the 13 percent hotel sales tax,
- 40 percent of the \$1.50 daily hotel occupancy tax,
- 1 percentage point of the 10 percent restaurant sales and use tax, and
- one-quarter of 1 percent increment of the business franchise surtax.

For the reporting periods October 1, 1994 through April 30, 1995, the District received and deposited \$16.2 million from these taxes in an escrow account at First Union National Bank of Washington in the name of the Washington Convention Center Authority. The funds are in a money market account earning 3.34 percent as of June 30, 1995. The \$16.2 million collected and transferred to date for the above mentioned 7-month period represents approximately 53 percent of the \$30.8 million in projected tax collections for fiscal year 1995.

Beyond collecting the new taxes, the convention center project has for the most part been on hold. Until the Congress amends the Home Rule Act, which Delegate Norton proposed under H.R. 1862, to permit the Authority to use these tax revenues, the Authority cannot contract for the various studies necessary to better define the project proposal for the new convention center. In our September 1994 report, we reported that such studies would need to be completed to better identify the economics of the project. The Authority estimates that it will cost about \$12 million to conduct these studies.

In addition, the Authority is dependent on the tax revenues to operate the existing convention center. With the implementation of the new dedicated taxes on October 1, 1994, the District's fiscal year 1995 budget eliminated the annual transfer of general funds to operate the existing convention center. Unable to use these dedicated revenues, the D.C. City Council authorized the Authority to receive up to \$5.7 million from the District's Rainy Day Fund to operate the current convention center. To date, the Authority has received \$2.2 million, but Authority officials believe that they will need the additional

\$3.5 million to cover projected operating costs for the balance of fiscal year 1995. The Authority is required to reimburse the Rainy Day Fund by September 30, 1995.

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This concludes my statement. My colleagues and I will be glad to answer any questions that you or other Members of the Subcommittee may have at this time.

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